

Sullivan County NH

Type of meeting: Board of Commissioners: Review Jeff Graham's Report Of MH&Co.,PC Draft Audit Report Findings

Date/Time: Tuesday, October 2, 2007; 7 PM

Place: Newport – Remington Woodhull County Complex, 14 Main Street – 1st Floor Commissioners' Conf. Rm.

Attendees: Commissioner Ethel Jarvis, Bennie Nelson, Jeffrey Barrette; Ed Gil de Rubio; Jeff Graham – Graham and Graham CPA; Dodi Violette – Account Clerk I; and Sharon Johnson-Callum (minute taker).

Public Attendees: State County Delegates John Cloutier, Ellen Nielsen, Larry Converse, Beverly Rodeschin, Brenda Ferland, Suzanne Gottling and Peter Franklin, Sheriff Michael Prozzo and Aaron Aldridge – Eagle Times Reporters.

7:00 p.m. Commissioner Chair Jarvis opened the meeting and asked who would be speaking first.

Mr. Gil de Rubio reminded the Board this was a follow up to their discussions on the draft audit, that Mr. Graham has been meeting with Melanson Heath & Company, PC (MH & Co.,PC), and that the Board, based on the Management report, needs to decide on their direction and advise MH & Co.,PC

It was asked if all in the room had copies of both the auditors draft financial statement and draft Management Letter. Some indicated no, so copies were made. Mr. Gil de Rubio noted they normally do not distribute these reports as drafts.

The Chair indicated to all she would recognize questions as long as kept short.

Mr. Jeff Graham noted a copy of his report was disbursed to all. He noted he tried to address each issue in the Management Letter, Annual Financial Statement and notes, and reviewed the following items from his report he distributed:

SUMMARY OF FINDINGS – He noted this was a four-page report

- ☐ Combined losses equaling \$ 1,586,000 for the fiscal year
- ☐ Nursing Home deficit at \$ 2,227,761
- ☐ Governmental Fund surplus \$ 641,000
- ☐ Revenues were under budget by \$ 1,406,200
- ☐ Expenditures over budget by \$ 60,541
- ☐ Encumbrances from prior year budgets, completed in 06/07 at \$ 1,205,256
- ☐ Year end audit adjustments at \$ 434,049

DEFICIT POSITION AT JUNE 2007

- ☐ 3rd and 4th Quarter revenue losses at Nursing Home at \$ 847,000 – Mr. Graham noted this amount should reflect \$873,000, as shown on the last page of his report.
- ☐ Caused short term borrowing requirements

TRANSITION FROM OLD SOFTWARE SYSTEM TO NEW

- ☐ Complicated the assessment of the deficit because of the newly recommended switch to Funds 30, 42 and 50, by Auditors

- ☐ Now changed to a more identifiable set of transactions
- ☐ Will continue to complicate budgetary line items usage for Department Heads and Manager
- ☐ Audit adjustments (between accounts payable and Encumbrances) provided in October 2006 for June 2006 year end entries caused under reported deficit during Q2-Q4

ENCUMBRANCES

- ☐ These are items that have been committed by the County but have not risen to the level of an invoice from a Vendor or Service provider
- ☐ The County rolled over \$ 1.2 million of commitments in to the FY 06/07 budget. Not enough fund balance (liquid) to cover these costs without borrowing. This also increased the deficit during FY 06/07
- ☐ Department Heads showed concern when these items hit their budgetary line items in 05/06 and again in 06/07 so Fund 50 was used to show Encumbrances from a prior year. Current (06/07) expenses were noted in appropriate Fund through out the fiscal year

BUDGETARY LINE ITEM CONSEQUENCES

- ☐ Due to the concerns of the Department Heads and for accurate reporting of all current and prior year expenditures and the limitations of the current software the County is placing all current and prior year expenditures in the current year budget lines.
- ☐ Every department Head will receive explicit details on their current and prior year status.
- ☐ The Commissioners (and Delegates?) will receive similar line item details for budget control purposes

INTERIM FINANCIAL STATEMENTS

- ☐ A September 30 2006 report was issued. This report placed the prior year Encumbrances in each applicable Fund. However, due to the above noted issues and the lack of clear prior year Encumbrance totals no subsequent reports were issued.
- ☐ The September 30 report contains the Encumbrances submitted for payment via invoices or other appropriate means.

YEAR END ADJUSTMENTS

- ☐ Each year audit adjustments change the account balances as reported by internal financial statements and budgetary statements. This year approximately \$ 400,000 in adjusting entries were recorded. This represents less than 2 % of the total expense totals, for such items as employee benefits, depreciation and other accruals.

MANAGEMENT LETTER COMMENTS

- ☐ SAS 112 changes, dramatically, the words used and the amount of items now required to be reported. This change will always make the Management Letter comments look severe, even in the best of organizations.
- ☐ The Statement (on Auditing Standards, or SAS) addresses the potential for issues or items to occur. This is in contrast to the previous SAS which noted them only if they did occur. Accordingly, expect to read this type of statement when it is addressed under control deficiency and material weakness sections.
- ☐ The Management Letter addresses five material weaknesses, which is now defined as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control system, and notes no control deficiencies.
- ☐ You can see from the definition and the use of the term "remote likelihood" that this can and will be used in every Management Letter issued to this County and other Auditee's since no system is perfect and guaranteed to stay that way.

RESOLUTION OF SHORT TERM BORROWING

- ☐ During the prior, and now current, fiscal year the County has borrowed significantly to fund the deficits. These borrowings can be termed out in to a 10 year note with annual principal

and interest payments, paid off with a special assessment to the County taxpayers or some combination of these items.

NH D.R.A. POSITION REGARDING BORROWINGS

- ☐ I have contacted Barbara Robinson about these issues and she will be providing guidance to the County with respect to their thoughts and approvals. He added, as of today, he has not heard from her.

RESOLUTION OF NURSING HOME DEFICITS CURRENT YEAR CHALLENGES

- ☐ It appears that all Funds and Departments are operating at or near their budget expectations, except the Nursing Home. In past years, the taxpayers of the County have been asked to fund around \$ 2 million dollars of the Nursing Home costs. This practice was changed two budget years ago to focus on a user fee system to cover the significant costs of the facility.
- ☐ It will continue to be the major challenge to the County to reverse this trend of significant and volatile operating conditions at the facility.
- ☐ It is the current thinking by Management that the first quarter of the fiscal year will show a deficit, the second quarter will be a quarter of change with continuing deficit balances, the third quarter will show progress at a smaller deficit and by the fourth quarter a break even will be noted. This will still equate to a large loss at the facility for the year.
- ☐ The new Administrator will be challenged to shorten the deficits and to organize an operation that can sustain its budget plans each fiscal year.

FINANCE DIRECTOR/INTERNAL AUDIT POSITION

- ☐ As discussed in the Management Letter and locally for two years, the County should advertise for an experienced Finance Director for the County. This position would also logically serve as the oversight for the issues described in the Melanson Heath Management Letter.
- ☐ The position would be the Chief Financial Officer for the County and would theoretically direct the accounting function, monthly reporting of data, work closely with the outside Auditors and have a constant presence in County finances.
- ☐ This position would work closely with the County Treasurer, Commissioners, Delegates and County Manager as well as with the Accounting and Finance Department personnel already employed.
- ☐ This position would work to lessen and eliminate the deficit at the Nursing Home and to continue to strengthen the reporting, controls, budget process, solving of accounting questions and overall fiscal responsibility of the County.

COMPONENTS OF THE 2006/2007 DEFICIT

- | | |
|---|--|
| <input type="checkbox"/> Combined Overall deficit (in thousands) | \$(1,586) |
| <input type="checkbox"/> Fund Balance allocated from prior year Net Assets | 209 – Mr. Graham noted this was planned. |
| <input type="checkbox"/> Net | (1,377) |
| <input type="checkbox"/> Revenue Shortfall in Nursing Home versus budget | 873 |
| <input type="checkbox"/> Net | (504) |
| <input type="checkbox"/> Depreciation Expense (greater than debt service paid) | 637 He noted this was non-cash portion. |
| <input type="checkbox"/> Net | 133 |
| <input type="checkbox"/> Note that the anticipated deficit was \$ 209 k of applied Net Assets from prior year surplus funds. | |
| <input type="checkbox"/> Of the total deficit, \$ 637 k is a non-cash expense for depreciation on capital assets. | |
| <input type="checkbox"/> And without a significant reduction in the final two Quarters Nursing Home revenues the deficit would have been predictable. | |

Mr. Graham provided the following overview

- ☐ MH & Co.,PC recommended establishing Funds 30, 42, and 50 (50 in FY 07), however he and MH & Co., PC feel it did not work well and MH & Co.,PC recommends removing 30 and 42.
- ☐ Encumbrances – Mr. Graham again defined encumbrances again (as in his report) and noted encumbrances only affect GAAP in the year they are used. He explained how department heads noted they were hit for the expenses once and then hit again in the next year budget when paid. The realization of these encumbrances is what caused a portion of the deficit shown in the Audit report. He confirmed Fund 50, per recommendations from the auditors, was created just for encumbrances. 4th quarter reports reflect financials based on GAAP, while 2nd and 3rd do not.
- ☐ Auditing standards – SAS112 changes the format of the Management letter. SAS112 addresses the potential for weaknesses to occur. For example, while someone is on vacation, if there is no cross training, it creates a weakness.
- ☐ The draft reports from auditors require the Board to make a clear determination of future visions. MH & Co.,PC requires input from the Board to insert wording in the two reports in order to pull the word "DRAFT" from their report and consider it final.
- ☐ He confirmed this was the first year the County had Fund 50 in the software. He explained encumbrances again, using the following chart.

	6/2007 Books	Budget	GAAP
1	05/06 Encumbrances @ 6/30/06	Yes	No
2	Payments of 05/06 Encumb	Yes	No (Fund)
3	C/Yr Adjustment (Fund 50)	No	Yes
4	Dept. Head Reaction to #3	No	No

Mr. Graham noted they took fund 50 at end of 1st quarter and sprinkled them into the various lines. He noted he and Ms. Violette spent a lot of time to tie in the numbers. He pointed out the auditor's end of FY06 Financial Statement vs. FY07 Draft Financial Statements beginning amount for encumbrance differs.

Mr. Graham recapped the following

- ☐ Actual Approved Budget 07/08 \$27,330,610
- ☐ Authorized Encumbrances Rolled Forward to 07/08 \$197,210
- ☐ New Authorization 07/08 (From Delegation) \$27,529,820
- ☐ 07/08 Budget Reconciliation

... and noted there is a mechanical issue they have to resolve each and every month to come up to this scenario.

Representative Gottling asked if there was a Fund 50? Mr. Graham confirmed yes. She noted it did not appear on her report. After a brief discussion it was discovered she was referring to a report dated 9/12/07, not the current reports run 10/02/07. Ms. Violette, per request of the auditors fund 50 was used to track encumbrances from previous year and to not include the fund on monthly reports.

Representative Ferland asked if there was any way to leave encumbrances in the dept budgets, to create a line so in each so they could track them easier? Mr. Graham confirmed that was his original thought. He is unsure if they can do that as the Delegation voted on the \$27,330,610. Commissioner Barrette and Mr. Graham

commenced debate regarding different scenarios on reflecting encumbrances, but it was noted any changes, changes the vote.

Commissioner Barrette questioned what happens to any left over cash at the end of the year. Mr. Graham noted, if it pertains to a grant, it would be an obligation to perform a grant and not the County's money.

Rep. Franklin asked two questions:

- 1) We are now into the second quarter; how much of the \$197,000 of encumbrances has been paid to date? Mr. Graham noted a lot of it has been, but was unsure the exact number.
- 2) That 197,000 is part of last years budget ...and when books closed at end of year, those encumbrances were included in the closing. If this were a perfect word, if we had a fund balance, those encumbrances would be out of this year? Mr. Graham concurred. Mr. Franklin recited the RSA regarding appropriations and not to go over. Mr. Graham confirmed he was aware of the RSA. Mr. Franklin commented, you said you've been talking about this, apparently you have not come to a meeting of the mind, as your presentation is the same as earlier; not sure what the point of this presentation is. Mr. Graham pointed out, per audit reports, the County needs to address Fund 50.

Rep. Rodeschin asked:

- 1) Is the DRA aware of this situation with all counties?
- 2) Where are encumbrances held and do you earn interest on it? Mr. Graham reminded her encumbrances are not cash, but obligations, a commitment, to pay using the financial resources of the County.
- 3) How do other counties handle this situation? It was noted there was one other county and a school district going through the same issues with MH & Co.,PC

Mr. Graham confirmed the \$500,000 line of credit appears on the GAAP report. Representative Franklin added that it was carried as a short-term liability. Mr. Graham pointed out there is a difference between outstanding debt and encumbrances.

At this point Mr. Graham provided another example:

- ☐ Engineering Company 06/07 encumbrance is \$10,000
- ☐ Their actual comes in at \$12,000
- ☐ \$10,000 relieves 07 encumbrance
- ☐ \$2,000 correct 08 budget line item
- ☐ \$12,000 GAAP expense amount

Commissioner Jarvis questioned what any of his report had to do with the Draft audit report? Mr. Graham noted, this was tying in all the issues, full and early disclosure is the best scenario, and noted these items complicated last years report and possibly this year. He noted the auditors want to know how they intend to deal with the deficit at the nursing home. He reviewed a couple scenarios:

1. Review last five years asset purchases as they could borrow and pay over a long period of time in a bond situation
2. Supplemental budget

Rep. Ferland indicated she feels they have three options:

1. Supplemental budget,

2. Long-term loan,
3. or pay the whole amount in 08/09 budget.

Rep. Ferland asked when the Board would make their decision? Commissioner Jarvis indicated they just received the reports, can't give an answer tonight and will meet again to discuss further. Commissioner Barrette feels they are unable to make an informed decision until DRA responds. Mr. Graham pointed out they could only place the bond issue if their assets were purchased recently. He pointed out they have very little debt, around 43,000 (vehicle lease), so could go from short term to long-term borrowing. He noted that was a discussion between him, MH & Co.,PC and the DRA. Commissioner Nelson noted the Board would like a finalized audit from MH & Co.,PC and input from DRA, before making their decision.

8:07 Rep. Ferland left the meeting.

Rep. Franklin feels the draft audit is final and indicated he called MH & Co.,PC who confirmed numbers have not changed. Mr. Graham refuted Mr. Franklin's statement, stating the audit report could change if MH & Co.,PC feels the County's response is inadequate. He noted, MH & Co.,PC will be adding a paragraph to the notes and Management Letter based on the County's response; and concurred numbers in the Financial Statement would not change. He reiterated the auditors recommended, for 07/08, eliminating Funds 30 and 42.

Rep. Franklin recommended they remove Fund 30 and 42 and see how it adds up, noting they would show a reduction. Mr. Graham noted removing Fund 30 would make a difference. Rep. Franklin questioned if the accounting system had the capability of tagging a line to show it's over expensed. Ms. Violette confirmed it does.

Rep. Rodeschin asked if this County problem would cause a problem for the municipalities sending out their tax bill? Rep. Franklin noted he'd attached a letter to the MS42, he previously signed, indicating the County had not been audited and that they were unaware if there was a surplus or deficit. Rep. Rodeschin noted as a community member of Newport she needed to know the amount owed by Newport, in order for their town to send tax bills.

Commissioner Barrette requested summarization of what the Board needed to respond to:

1. What are we doing with fund 30, 42, and 50? Mr. Graham recommends eliminating Fund 30 and 42.
2. What are we going to do with our debt?
3. Tell us how you are going to eliminate, manage, and reduce this years deficit?

Rep. Franklin asked Mr. Graham if he agreed with the figures as presented by the audit; and if there were any significant changes? Mr. Graham confirmed the numbers are the numbers and concurs with the adjusting entries made in September for year-end. He again discussed end of year FY 06 encumbrances and the number reflected at the beginning of the year in the audit. He noted the auditors and he became, throughout this process more aware of the County's software processes.

8:30 Sheriff Prozzo and Rep. Rodeschin left the room.

As a result of a very lengthy debate between Rep. Franklin and Graham, Commissioner Jarvis gaveled and requested the conversation to stop.

Rep. Nielsen asked where the County attained the nursing home census data from; and its usefulness for predicting the future? Commissioner Jarvis indicated they based the budget on predictions of the former SCHC Administrator, and assured her if they had reduced the bed count, their numbers would be a lot different now and they would not let this happen again. Commissioner Nelson pointed out the census in the first ½ of year was there. Commissioner Barrette noted they were running at a 148 census, then it dropped. Rep. Gottling noted they were not meeting the budget of the Medicaid Skilled Care. Commissioner Barrette indicated a huge portion is driven from lack of continuity in management, which he noted they are trying to change; that it's hard to budget when only on board for six months, that experience is needed on the Board and with his inexperience he was not driven to ask more questions. He finalized by saying, the anticipation to keep it off the tax rolls guided the budget and feels they lost sight of the truth.

Rep. Neilson feels it unrealistic for taxpayers to assume they will not have to do something to take care of the poor elderly people, and asked if they thought the same? Commissioner Barrette noted he feels it's not unreasonable to ask taxpayers to foot a portion of the bill and it's their fiduciary responsibility to make it as low as they can. Rep. Nelson commented, if Concord did away with neutrality factor and paid the Medicaid rate it would certainly help. He also noted their spending was not "willy nilly" as implied earlier and pointed out the infrastructure was crumbling. Commissioner Barrette feels they are making strides and did an accurate forecast in the FY 08 budget.

Rep. Cloutier pointed out MH & Co.,PC noted the total deficit was 2.2 million, but Mr. Graham indicated 1.5; and asked what number they should settle on? Mr. Graham referred them to page 10 of the MH & Co.,PC audit report, total change in net assets that noted stated 1.586 deficit. Commissioner Jarvis refuted the statement noting she spoke directly to MH& Co.,PC who indicates 2.2 million. Mr. Graham asked her to answer the question, "What is the definition of all budgeted funds?". He noted GAAP deficit is 1.586, which is all accounts. Rep. Gottling pointed out on page 3 of management letter also indicates 2.2 million short fall. Mr. Graham pointed out 2.2 million represents the overall deficit for the budget report.

8:55 Rep. Gottling left room, followed immediately by Rep. Franklin.

8:57 Rep. Franklin returned to the room.

Mr. Graham discussed the net assets difference between 06 to 07, which is 1.586. He noted the statement of net assets and activities shows you all changes; \$6,783 is 06, \$5,172 is 07, a difference of 1.6 million. Commissioner Barrette noted knowing the deficit number is important to him as it needs to tie into short term borrowing/long term debt; "we need to back that up".

Rep. Franklin noted he wanted the auditors to come to the County. Commissioner Barrette noted he'd like to know options to relieve debt and process associated with it.

9:05 Rep. Gottling returned.

Rep. Franklin and Commissioner Barrette discussed interpretations and protocol regarding supplemental budget requests. They discussed bond votes and Mr. Franklin noted this requires Delegation approval. Commissioner Barrette asked what the cost of a supplemental budget or rolling into long-term debt would be; and requested the County Manager to come up with various proposals.

Commissioner Jarvis requested a meeting with MH & Co.,PC.

Commissioner Barrette stated there is a (FY 07) 2.5 short-term tax anticipation debt needing to be taken care of.

Representative Franklin noted the Commissioner and Delegates, per statutes, are allowed to ask any questions of the auditors.

Commissioner Jarvis thanked Mr. Graham for his input.

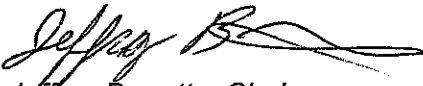
Commissioner Jarvis asked for any further public participation.

Ms. Violette asked Mr. Graham if it was fair assumption that end of year financial reports would show 2.2 million deficit, as it's not GAAP (which is 1.5), since these are budgeted reports? Mr. Graham confirmed yes.

Rep. Gottling questioned what the amounts represented in the Fund 50 encumbrance column. She also noted there were amounts reflected in the encumbrance column, throughout the monthly reports. Ms. Violette clarified that Fund 50 included encumbrance amounts brought from the previous year and when money was used, during the following year, the encumbrance column reflects the difference between the original encumbrance and amount paid out. However, on the draft July and August monthly reports, the encumbrance amounts reflected, in all accounts other than Fund 50, were purchase orders created in FY 08 not yet approved or paid out.

9:15 Commissioner Nelson moved to adjourn the meeting. Commissioner Barrette seconded the motion. There was no discussion. A voice vote was taken. The motion carried, unanimously.

Respectfully submitted,


Jeffrey Barrette, Clerk
Board of Commissioners

JB/s.j-c.

Date signed: 10/24/07 -